INTRODUCTORY MANUAL

FOR

The 10 Keys to Successful Trading

Technical Analysis Applications for the Currency Markets

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VISIT…

I am your constant companion,
I am your greatest helper or your heaviest burden.
I will push you onward or drag you down to failure.
I am at your command.

Half of the tasks that you do you might just as well
Turn over to me and I will do them quickly and correctly.

I am easily managed; you must merely be firm with me.
Show me exactly how you want something done.
After a few lessons, I will do it automatically.

I am the servant of all great people
And the regret of all failures as well.
Those who are great, I have made great.
Those who are failures, I have made failures.

I am not a machine but I will work with all its precision
Plus the intelligence of a person.

Now you may run me for profit or you may run me for ruin.
It makes no difference to me.

Take me, train me, be firm with me and
I will lay the world at your feet.
Be easy with me and I will destroy you.

I am called Habit!

Author Unknown

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A Traders Mission And Goal

It is the mission of the trader to become a financially successful long-term trader. This can be achieved when the trader adopts and accepts ***The 10 Keys of Successful Trading***. The trader must commit to live by the three disciplines that create the successful trader.

1. **The trader must believe in *The 10 Keys to Successful Trading* and merge them into his personality.** His success is dependent on creating a trading plan, and maintaining the discipline to TRADE THE PLAN!

2. The trader must commit himself to continued education and learn as much as he can about technical analysis and the psychology of successful trading. **He must use logic, and not his emotions, in trading.** The trader must learn to trade in control, not out of control!

3. **The trader must map out a sound plan of equity management to insure a return on his investment.** A successful plan is to trade no more than 20% of a margin account and risk no more than 5 to 10% of that account on any single trade.

Levels Of A Trader

LEVEL ONE: Beginner Trader - To study and paper trade for a minimum of one month with imaginary money, gaining the experience required to establish a track record of profitable performance.

LEVEL TWO: Advanced Beginner - To trade one or two lots with real money, working through emotions and establishing a track record of making money.

LEVEL THREE: Competent Trader - To trade in control with equity management, achieving a financial return.

LEVEL FOUR: Proficient Trader - To trade based on my belief, education, and experience and achieves a financial return.

LEVEL FIVE: Expert Trader - To mechanically execute profitable trades with no emotion.

CHAPTER 1 - *WHAT IS THE FOREX?*

- FOREX = FOReign EXchange
- You can trade 24 hours a day
- The FOREX is larger than all other financial markets COMBINED

The Foreign Exchange (FOREX) market is a cash (or "spot") interbank market established in 1971 when floating exchange rates began to materialize. This market is the arena in which the currency of one country is exchanged for those of another and where settlements for international business are made.

The FOREX is a group of approximately 4500 currency trading institutions, including international banks, government central banks and commercial companies. Payments for exports and imports flow through the Foreign Exchange Market, as well as payments for purchases and sales of assets. This is called the "consumer" foreign exchange market. There is also a "speculator" segment in the FOREX Companies, which have large financial exposures to overseas economies participate in the FOREX to offset the risks of international investing.

Historically, the FOREX interbank market was not available for small speculators. With a previous minimum transaction size and often-stringent financial requirements, the small trader was excluded from participation in this market. But today market maker brokers are allowed to break down the large interbank units and offer small traders the opportunity to buy or sell any number of these smaller units (lots).

Commercial banks play two roles in the FOREX market:

(1) They facilitate transactions between two parties, such as companies wishing to exchange currencies (consumers), and

(2) They speculate by buying and selling currencies. The banks take positions in certain currencies because they believe they will be worth more (if "buying long") or less (if "selling short") in the future. It has been estimated that international banks generate up to 70% of their revenues from currency speculation. Other speculators include many of the worlds' most successful traders, such as George Soros.

The third category of the FOREX includes various countries' central banks, like the U.S. Federal Reserve. They participate in the FOREX to serve the financial interests of their country. When a central bank buys and sells its or a foreign currency the purpose is to stabilize their own currency's value.

The FOREX is so large and is composed of so many participants, that no one player, even the government central banks, can control the market. In comparison to the daily trading volume averages of the $300 billion in the U.S. Treasury Bond market and the approximately $100 billion exchanged in the U.S. stock markets, the FOREX is huge, and has grown in excess of $1.5 trillion daily.

The word “market” is a slight misnomer in describing FOREX trading. There is no centralized location for trading activity (“pit”) as there is in the currency futures (and many other) markets. Trading occurs over the phone and through the computer terminals at hundreds of locations worldwide. The bulk of the trading is between approximately 300 large international banks, which process transactions for large companies, governments and for their own accounts. These banks are continually providing prices (“bid” to buy and “ask” to sell) for each other and the broader market. The most recent quotation from one of these banks is considered the market’s current price for that currency. Various private data reporting services provide this “live” price information via the Internet.

There are numerous advantages for parties wishing to trade in the FOREX. They include:

Liquidity: In the FOREX market there is always a buyer and a seller! The FOREX absorbs trading volumes and per trade sizes which dwarfs the capacity of any other market. On the simplest level, liquidity is a powerful attraction to any investor as it suggests the freedom to open or close a position at will 24 hours a day.

Once purchased, many other high-return investments are difficult to sell at will. FOREX traders never have to worry about being “stuck” in a position due to lack of market interest. In the 1.5 trillion U.S. dollar per day market, major international banks a “bid” (buying) and “ask” (selling) price

Access: The FOREX is open 24 hours daily from about 6:00 P.M. Sunday to about 3:00 P.M. Friday. An individual trader can react to news *when it breaks,* rather than waiting for the opening bell of other markets when everyone else-has the same information. This allows traders to take positions before the news details are fully factored into the exchange rates. High liquidity and 24 hour trading permit market participants to take positions or exit regardless of the hour. There are FOREX dealers in every time zone, in every major market center (Tokyo, Hong Kong, Sydney, Paris, London, United States, etc.) willing to continually quote buy and sell prices.

Since no money is left on the market “table,” this is what is referred to as a “Zero Sum Game” or “Zero-Sum Gain.” Providing the trader picks the right side, money can always be made

Two-Way Market: Currencies are traded in pairs, for example dollar/yen, or dollar/Swiss franc. Every position involves the selling of one currency and the buying of another. If a trader believes the Swiss franc will appreciate against the dollar, the trader can sell dollars and buy francs ("selling short!'). If one holds the opposite belief, that trader can buy dollars and sell Swiss francs ("buying long"). The potential for profit exists because there is always movement in the exchange rates (prices).

FOREX trading permits profit taking from both rising and falling currency values in relation to the dollar. In every currency trading transaction, one of the sides of the pair is always gaining and the other side is losing.

Leverage: Trading on the FOREX is done in currency "lots." Each lot is approximately 100,000 U.S. dollars worth of a foreign currency. To trade on the FOREX market, a "margin account" must be established with a currency broker. This is, in effect, a bank account into which profits may be deposited and losses may be deducted. These deposits and deductions are made instantly upon exiting a position.

Brokers have differing margin account regulations, with many requiring a $1,000 deposit to "day-trade" a currency lot. Day-trading is entering and exiting positions during the same trading day. For longer-term positions, many require a $2,000 per lot deposit. In comparison to trading in stocks and other markets, which may require a 50% margin account, FOREX speculators excellent leverage of 1% to 2% of the $100,000 lot value. The trader can control each lot for I to 2 cents on the dollar!

Execution Quality: Because the FOREX is so liquid, most trades can be executed at the current market price. In all fast moving markets, slippage is inevitable in all trading (stocks, commodities, etc.), but can be avoided with some currency broker's software, which informs you of your exact entering price just prior to execution. You are given the option of avoiding or accepting the slippage. The huge FOREX market liquidity offers the ability for high quality execution.

Confirmations of trades are immediate and the Internet trader has only to print a copy of the computer screen for a written record of all trading activities. Many individuals feel these features of Internet trading make it safer that using the telephone to trade. Respected firms such as Charles Schwab, Quick & Reilly and T.D. Waterhouse offer Internet trading. They would not risk their reputations by offering Internet service if it were not

reliable and safe. In the event of a temporary technical computer problem with the broker's ordering system, the trader can telephone the broker 24 hours a day to immediately get in or out of a trade.

Internet brokers' computer systems are protected by "firewalls" to keep account information from prying eyes. Account security is a broker's highest concern. They have taken multiple steps to eliminate any risk associated with transacting on the Internet.

A FOREX Internet trader does not have to speak with a broker by telephone. The elimination of the middleman (broker salesman) lowers expenses and makes the process of entering an order faster and has eliminated the possibility for misunderstanding.

- **Execution Costs:** Unlike other markets, the FOREX does not charge commissions. The cost of a trade is represented in a Bid/Ask spread established by the broker. (Approximately 4 pips)

- **Trendiness:** Over long and short historical periods, currencies have demonstrated substantial and identifiable trends. Each individual currency has its own "personality," and each offers a unique historical pattern of trends, providing diversified trading opportunities within the spot FOREX market.

- **Focus:** Instead of attempting to choose a stock, bond, mutual fund or commodity from the tens of thousands available in those markets, FOREX traders generally focus on I to 4 currencies. The most common and most liquid are the Japanese Yen, British Pound, Swiss Franc and the new EURO. Highly successful traders have always focused on a limited number of investment options. Beginning FOREX traders usually will focus on one currency and later incorporate one to three more into their trading activities.

- **Margin Accounts:** Trading on the FOREX requires a margin account. You are committing to trade and take positions today. As a speculator trader you will not be taking delivery on your product that you are trading. As a Stock Day Trader, you will only hold a trading position for a few minutes to a few hours, and then you need to close out your position by the end of the trading session.

  All orders must be placed through a broker. To trade stocks you will need a stockbroker and to trade currencies you will need a Forex currency broker. Most brokerage firms have different margin requirements. You need to ask them their margin requirements to trade stocks and currencies.

A margin account is nothing more than a performance bond. All traders need a margin account to trade. When you gain profits, they place your profits into your margin account the same day you profited. When you lose profits, they need an account to take out the losses you incurred that day. All accounts are settled daily.

A very important part of trading is, taking out some of your winnings or profits. When the time comes to take out your personal gains from your margin account, all you need to do is contact your broker and ask them to send you your requested dollar amount, and they will send you a check. They can also wire transfer your money.

Chapter 3
READING CANDLESTICK CHARTS

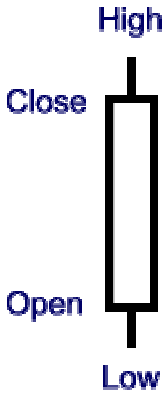
In the Seventeenth century, the Japanese developed a method to analyze the price of rich contracts. This technique is called "candlestick charting. Steven Nison is credited with popularizing the candlestick chart and has become recognized as the leading authority on the interpretation of the system.

Candlesticks chart the price fluctuations of a product. A candlestick can represent any period of time. A currency trader's software can provide charts representing anywhere from five minutes to one week per candlestick.

Candlestick charts do not involve any calculations. They simply chart price movements in a given time period. Each candlestick displays four important pieces of information, which show the price fluctuations during the time period of the candle. In much the same way as the more widely-known bar chart, a candle give us the opening price, the closing price, the highest price and the lowest price of the time period. Candlesticks are easier to use because they more clearly demonstrate the relationship between the opening and closing prices.

Because candlesticks display the relationship between the open, high, low and closing prices, they cannot be used to chart securities that have only closing prices.

The interpretation of candlestick charts is based on patterns. Currency traders use primarily the relationship of the highs and lows of the candlewicks over a given time period. However, some patterns can be identified to anticipate price movements. There are two types of candles: the *bullish* pattern candle and the *bearish* pattern candle.

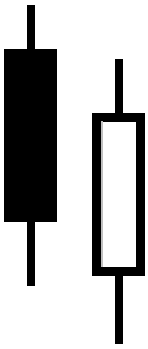


A white or empty body displays the bullish candle pattern. It occurs when prices open near the low price and close near the period's high price.

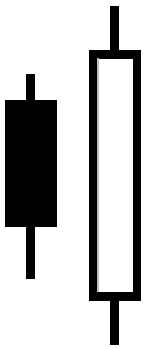
A black or filled body displays the bearish candle pattern. It occurs when prices open near the high price and close near the period's low price.

Bullish Candlestick Formations

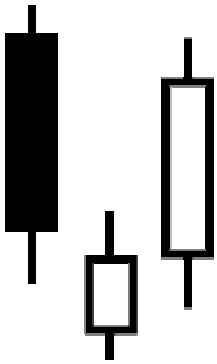
Hammer - The hammer is a bullish pattern if it occurs after a significant downtrend. If the line occurs after a significant uptrend, it is called a hanging man. A small body and a long wick identify a hammer. The body can be clear or filled in.



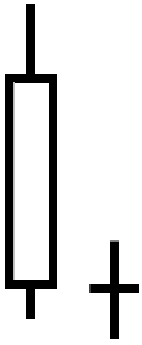
Piercing Line - This is a bullish pattern. The first candle is a long bear candle followed by a long bull candle. The bull candle opens lower than the bear's low but closes more than halfway above the middle of the bear candle's body.



Bullish Engulfing Lines - This pattern is strongly bullish if it occurs after a significant downtrend (it may serve as a reversal pattern). It occurs when a small bearish (filled-in) candle is engulfed by a large bullish (empty) candle.



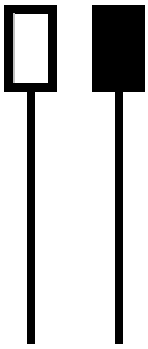
Morning Star - This is a bullish pattern signifying a potential bottom. The star indicates a possible reversal and the bullish (empty) candle confirms this. The star can be a bullish (empty) or a bearish (filled-in) candle.



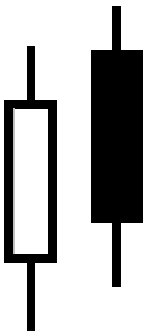
Bullish Doji Star - This star indicates a reversal and a doji indicates indecision. Thus, this pattern usually indicates a reversal following an indecisive period. You should wait for a confirmation before trading a doji star.

Bearish Candlestick Formations

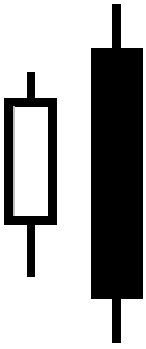
Long Bearish Candle - A long bearish candle occurs when prices open near the high and close lower near the low.



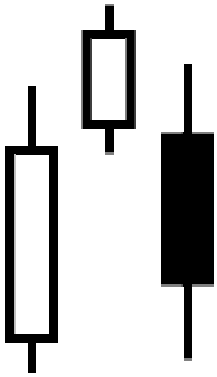
Hanging Man - This pattern is bearish if it occurs after a significant uptrend. If this pattern occurs after a significant downtrend, it is called a hammer. A hanging man is identified by small candle bodies and a long wick below the bodies (can be either clear or filled in).



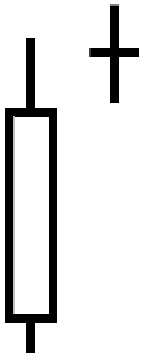
Dark Cloud Cover - This is a bearish pattern. The pattern is more significant if the second candle's body is below the center of the previous candle's body.



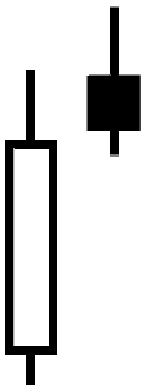
Bearish Engulfing Lines - This pattern is strongly bearish if it occurs after a significant uptrend (it may serve as a reversal pattern). It occurs when a small bullish (empty) candle is engulfed by a large bearish (filled-in) candle.



Evening Star - This is a bearish pattern signifying a potential top. The star indicates a possible reversal and the bearish (filled-in) candle confirms this. The star can be a bullish (empty) candle or a bearish (filled-in) candle.

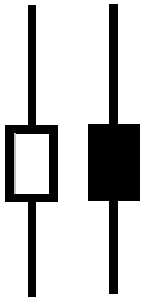


Doji Star - This star indicates a reversal and a doji indicates indecision. Thus, this pattern usually indicates a reversal following an indecisive period. One should wait for a confirmation (like a evening star) before trading a doji star.



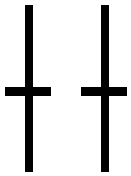
Shooting Star - This pattern suggests a minor reversal when it appears after a rally. The star's body must appear near the low price, and the candle should have a long upper wick.

Neutral Candlestick Formations

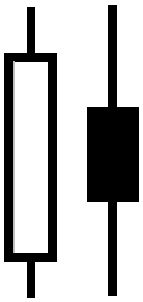


Spinning Tops - This is a neutral pattern that occurs when the distance between the high and low, and the distance between the open and close, are relatively small.

Doji - This candle implies indecision. The open and close are the same.



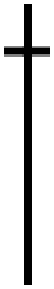
Double Doji - This candle (two adjacent doji candles) implies that a forceful move will follow a breakout from the current indecision.



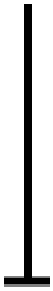
Harami - This pattern indicates a decrease in momentum. It occurs when a candle with a small body falls within the area of a larger body. This example a bullish (empty) candle with a large body is followed by a small bearish (filled-in) candle. This implies a decrease in the bullish momentum.

Reversal Candlestick Formations

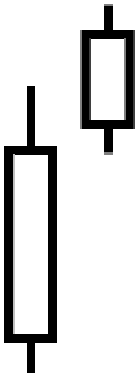
Long-legged Doji - This candle often signifies a turning point. It occurs when the open and close are the same, and the range between the high and the low is relatively large.



Dragonfly Doji - This candle also signifies a turning point. It occurs when the open and close are the same, and the low is significantly lower than the open, high and closing prices.



Gravestone Doji - This candle also signifies a turning point. It occurs when the open, close and low prices are the same, and the high is significantly higher than the open, close and low prices.

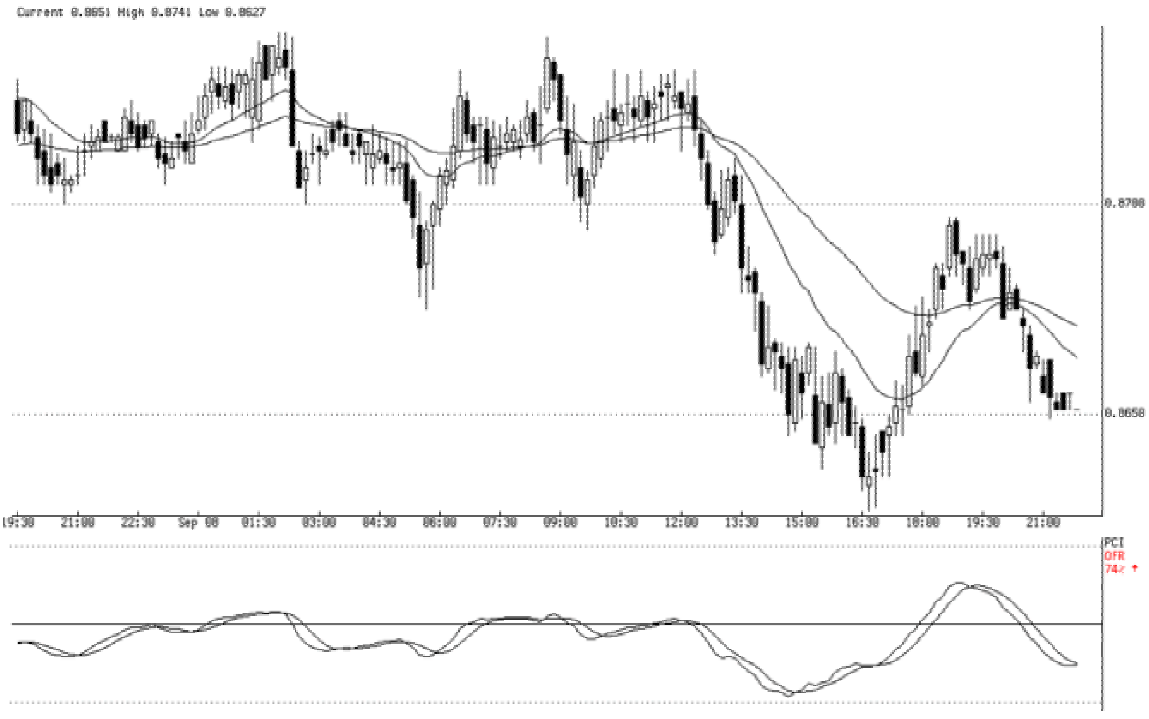


Stars - Stars indicate reversals. A star is a candle with a small real body that occurs after a candle with a much larger real body, where the real bodies do not overlap (the wicks may overlap).

Current 1.4137 High 1.5135 Low 1.4132
Engulfing Bearish
Doji
Morning Star
Tweezer Bottom
1.5000
1.4500
Aug 11 Aug 15 Aug 17 Aug 21 Aug 23 Aug 25 Aug 29 Aug 31 Sep 04 Sep 06 Sep 08

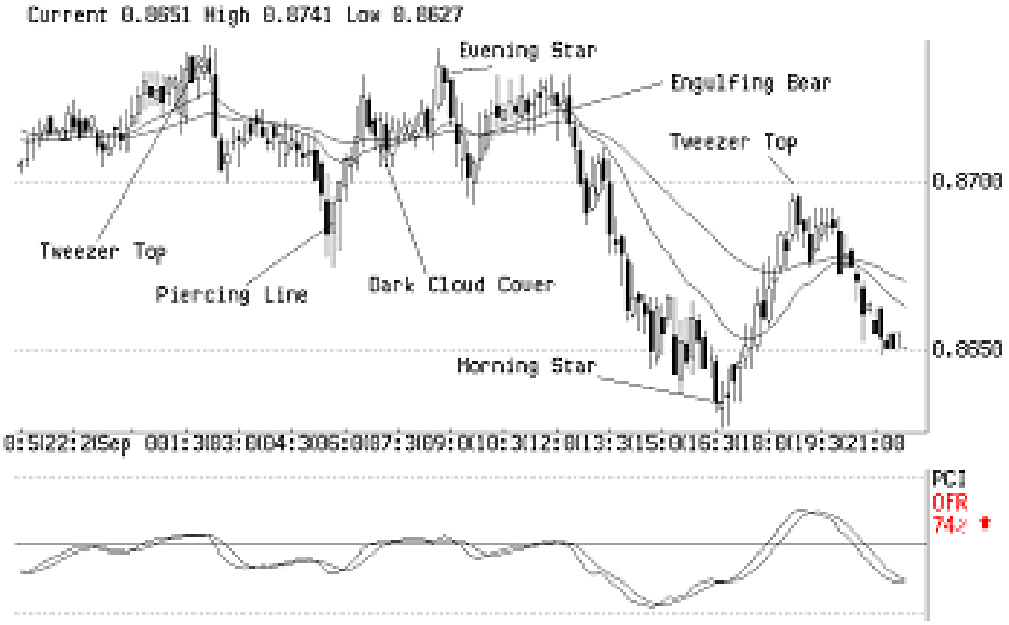
You can also interpret stock charts using candlesticks as shown below for BancOne Corporation.

Exercise: Circle and identify the candlestick formations in the following Charts.



Answers to the Exercises

Current 11220.60 High 11423.90 Low 9732.70
Star
Dark Cloud Cover
Tweezer Top
Evening Star
Dark Cloud Cover
Hanging Man
11000.00
10500.00
10000.00
Piercing Line
Dojis
Morning Star
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep


Current 0.8851 High 0.8741 Low 0.8827
Evening Star
Engulfing Bear
Tweezer Top
0.8700
Tweezer Top
Piercing Line
Dark Cloud Cover
0.8650
Morning Star
PCI
OFR

Chapter 4

TYPES OF ORDERS

- Sellers are **ASK**ing for a high price
- Buyers are **BID**ding at a lower price
- Trading is an auction
- Slippage occurs with most Market Orders
- The difference between the ASK and the BID price is the Spread

A Trader must understand what each order is and does and what part it plays in capturing profit. As a Trader on the FOREX you use three types of orders: a Market Order, a Limit Order, and a Stop Order. The two primary orders you should use for entering and exiting the market are a Limit Order and a Stop Order. Once you have placed your order to enter the market, there are two procedures to that your need to understand. These are: One-Cancels-the-Other (OCO) and Cancel-and-Replace. Properly executing your orders and understanding these procedures play a very big part in your profitability.

Remember: all good carpenters carry a toolbox. The sharper his tools and the more skilled he is at using them, the more effective he is. The sharper you are as a trader the more effective and profitable you will become.

The following explains in detail what each order does. You must clearly understand what each order does before you start to execute your orders.

Market Orders: A Market Order is an order that is given to a broker to buy or sell the currency at whatever the market is trading for at that moment. It can be an entry order into the market or an exit order to get out of the market. Traders use Market Orders when they are ready to make a commitment to enter or exit the market. You must be very careful when using Market Orders in fast moving markets. In fast rallies or down reactions you can gain or lose many points to slippage before you receive your fill.

Trading is an auction where there are buyers (bidders) and sellers (offerers). The bid is the "buy" and the "ask", or offer is the sell. Slippage is defined as: when a trade is executed between a buyer and seller and the resulting buy or sell transaction is different than the price you saw just prior to order execution. With Market Orders you will lose on average one to six pips, if not more, due to slippage. Market Orders are rarely filled at the exact price you are expecting. **We Recommend caution when entering or exiting with a Market Order.**

Limit Orders: Limit Orders are orders given to a broker to buy or sell currency lots at a certain price or better. The term Limit means exactly what it says. You will buy at that exact limit price or better a large majority of the time. Limit Orders are used to enter and exit the market. They are generally used to acquire a specific price, avoiding slippage and unwanted order fills (execution price) which can happen with Market Orders.

When you sell above the market, it is a Limit Order. When you buy below the market, it is a Limit Order. A limit order will be executed when the market trades through it. Seventy to ninety percent (70% to 90%) of the time, if the market is trading at your Limit Order it will be executed. The market ***must*** trade through you specified Limit Order number to ***guarantee*** a fill. The computer will notify you within seconds of your fill. You do not have to call your broker to see if you have been filled.

Stop Orders: Stop Orders are orders placed to enter or exit the market at a desired specific price. When you buy above the market, it is a Stop Order. When you sell below the market, it is a Stop Order. Stop Orders turn into Market Orders when the market trades at that price. Stop Orders as well as Market Orders are subject to slippage, while Limit Orders are not.

The majority of Stop Orders are used as protective Stop Loss Orders. It is the order you place with your entry order to insure an exit when the market goes against you. A good trader never trades without a protective Stop Loss Order. They are orders executed to get you out of the market when your trade has gone against you. Protective Stops are discussed separately as one of the *10 Keys to Successful Trading*.

One Cancels the Other (OCO): Whenever you enter the market, you must exit the market at some future time. An OCO order is a procedure and means one-cancels-the-other. Once you have entered the market, you should place a protective Stop Loss Order and have in mind a projected profit target. That projected profit target can be your Limit Order. If you simultaneously place both Limit and Stop Loss Orders when you enter the market, you can OCO them and walk away from your computer. What does that mean? At some future point in time either your Stop Order or Limit Order will be executed, automatically canceling your opposing order. If the trader is so sure about the trade, he can execute an OCO order and walk away from the trade. The computer will than manage the trade.

Cancel/Replace Orders: A Cancel/Replace Order is a procedure and not an entry or exit order. By definition it is when the trader cancels an existing open order and replaces it replace it with a new order. A cancel/replace order is primarily a strategy of trading and is predominately used after one has taken a position in the market and wants to stay in the market locking in profit. For example: you buy Swiss at 1.410. Your protective Stop Loss Order is 1.390. The market moves in you direction as projected. You now want to reduce your

potential loss, so you cancel your Stop Order at 1.390 and replace it to 1.410 where you got in. You are now in a trade with no risk. As the market moves further north in your direction, you now want to lock in more profit. You cancel your 1.410 Stop Loss Order and replace it with a new 1.440 Stop Loss Order. You now have locked in 30 Pips in profit. You are in an all-win, no-risk trade. You keep canceling and replacing your Stop until you are finally stopped out. This is discussed separately under Protective Stops as one of the *10 Keys to Successful Trading*.